

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
INR-07 USIA-06 XMB-02 OPIC-03 SP-02 CIEP-01 LAB-04
SIL-01 OMB-01 NSC-05 SS-15 STR-04 CEA-01 NSA-01 /082 W
-----181703 096450 /42

R 181425Z FEB 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 0795
TREASURY DEPT WASHDC
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DEPARTMENT PASS COUNCIL OF ECONOMIC ADVISERS & FEDERAL
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E.O. 11652: N/A
TAGS: EFIN, UK
SUBJECT: EDRC REVIEW OF THE UNITED KINGDOM

REF: A) PARIS 4809; B) GDR (77)6; C) LONDON 20292--1976

1. EMBASSY CONSIDERS THAT SECRETARIAT PAPER IS A WELL
ROUNDED JOB, ALTHOUGH ONE COULD PICK ON SELECTIVE POINTS.

2. FOR EXAMPLE, SECRETARIAT'S \$1/2 BILLION CURRENT AC-
COUNT DEFICIT FOR 1977 (PARA 9, REF A). GIVEN JANUARY'S
CURRENT DEFICIT OF \$585 MILLION (AT \$1.70) IS SECRETARIAT
STILL AS OPTIMISTIC? UK EXPECTS DEFICIT OF ABOUT \$2.5
BILLION (AT \$1.65 AVERAGE EXCHANGE RATE FOR THE YEAR)
WHICH MAY BE HIGH. RECALL THE IMF LETTER OF INTENT FORE-
CASTS THE CURRENT DEFICIT WILL FALL FROM "OVER 2 BILLION
POUNDS IN FY 76/77 TO ABOUT 1 BILLION POUNDS IN FY 77/78
AND THEN MOVE INTO A SUPRLUS OF 2 TO 3 BILLION POUNDS IN
78/79." FOR 1977, MOST INDEPENDENT MACROECONOMIC FORE -
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CASTS SEE A DEFICIT OF FROM 500 TO 750 MILLION POUNDS
(\$825 MILLION TO \$1.2 BILLION) AS MORE PROBABLY, EXCEPT
THE NATIONAL INSTITUTE WHOSE LAST PUBLISHED FORECAST
(NOVEMBER) SAW A CURRENT SURPLUS OF \$1.8 BILLION. THE
EMBASSY STILL CONSIDERS A CURRENT DEFICIT IN THE RANGE OF
\$1.2 - \$1.8 BILLION AS HIGHLY PROBABLY. CONSIDERABLE
QUESTIONING COULD BE DIRECTED IN THIS GENERAL AREA.

EQUALLY (PARA 11 REF A) STERLING EXCHANGE MARKETS SHOULD BE LESS VOLATILE IN 1977 BUT NOT NECESSARILY QUIESCENT.

3. STILL NITPICKING (PARA 12, REFA), HAD CRISIS MEASURES NOT BEEN RELUCTANTLY ADOPTED IN OCTOBER, MONETARY POLICY COULD WELL HAVE BEEN RESPONSIBLE FOR MORE INFLATIONARY PRESSURE THAN WAS THE CASE. THE SECRETARIAT'S ASSERTION THAT THERE IS NO ESTABLISHED EMPIRICAL RELATION IN THE UK BETWEEN GROWTH OF MONETARY SUPPLY AND PRICE INCREASES IS SERIOUS, AND POSSIBLY MISLEADING. THE ASSERTION TENDS TO MINIMIZE THE AIMS OF A POLICY UPON WHICH THE UK IS RELYING HEAVILY. THE UK'S RESPONSE AND COMMENT SHOULD BE ELICITED. DOES THE OECD HAVE ANY ESTIMATES OF ITS OWN?

4. IN GENERAL, HOWEVER, THE SECRETARIAT DOCUMENT AND MISSION SUMMARY AND COMMENTS (REFA) DO PICK UP THE MAIN THREADS AND DIFFICULTIES FACING THE UK. BELIEVE IT WILL BE IMPORTANT TO TRY TO FOCUS DISCUSSION NOT ON WHAT HAS HAPPENED IN THE PAST BUT RATHER WHAT IS LIKELY TO HAPPEN IN THE FUTURE. ONE LINE OF APPROACH WOULD BE TO ASK THE UK TO PICK UP ON H.M. TREASURY FORECAST OF ECONOMIC PROSPECTS TO END 1977 (REF C), INQUIRE WHAT CHANGES MIGHT HAVE BEEN MADE TO THE FORECAST SINCE IT WAS RELEASED OR WHAT CHANGES SHOULD BE ENVISAGED. INFLATIONARY PROFILE THROUGH END 1978 SHOULD BE EXPLORED. SECRETARIAT PAPER CONFUSES RATHER THAN CLARIFIES THE COMPOSITION OF UK INFLATION; E.E., HOW MUCH RESULTS FROM THE FALL IN THE POUND DUE TO EXTERNAL FACTORS; HOW MUCH RESULTS FROM DOMESTICALLY GENERATED INFLATION, THROUGH INFLATIONARY LIMITED OFFICIAL USE

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PRESSURES OF PUBLIC SECTOR BORROWING AND MONEY SUPPLY; DOMESTIC EARNINGS EXCEEDING PRODUCTIVITY, ETC. UK DELEGATION VIEWS ON THIS SHOULD BE SOUGHT IN TERMS OF WHAT IS EXPECTED TO HAPPEN IN THE FUTURE.

5. THE SECRETARIAT AND THE UK TREASURY FORECAST POSITIVE GROWTH IN REAL NATIONAL PRODUCT, IN LARGE PART BASED ON HIGH RATES OF INVENTORY ACCUMULATION. STOCKS ARE USUALLY BUILT UP IN ANTICIPATION OF CHANGES IN ONE OR ANOTHER VARIABLE, E.G., SALES AND PRICES. SOME EXPLANATION OF THE RELATIONSHIP BETWEEN INVENTORY EXPANSION ESTIMATES AND GDP GROWTH FORECASTS IN THE OECD AND UK TREASURY FORECASTS WOULD BE USEFUL.

6. UK VIEWS SHOULD ALSO BE SOUGHT ON NORTH SEA OIL BENEFITS PROFILE BOTH IN TERMS OF BALANCE OF PAYMENTS AND FISCAL PAY OFF. WHAT MAJOR CHANGES HAVE BEEN MADE IN FORECASTS SINCE THE JULY 1976 H.M. TREASURY ESTIMATES?

7. LONGER TERM UK INTENTIONS CONCERNING RESTRUCTURING OF UK INDUSTRY SHOULD ALSO BE QUERIED. SECRETARIAT PAPER MAY GIVE TOO MUCH IMPORTANCE TO CONTINUATION OF INCOMES POLICY. AT SOME POINT IT IS BOUND TO BREAK DOWN. IMPORTANT FACT IS NOT WHETHER THERE IS A PHASE 3, BUT RATHER HOW EFFECTIVE IT WILL BE AND HOW GREATLY IN EXCESS OF PRODUCTIVITY, EARNINGS INCREASES WILL BE, NOW AND IN THE FUTURE. THE SECRETARIAT POINTS TO A SHORT RUN SHIFT AWAY FROM LABOR-INTENSIVE PRODUCTION OF GOVERNMENT SERVICES E.E., PUBLIC CONSUMPTION (PARA 6, REF A). THE UK HAS ANNOUNCED ITS INTENTION TO REDUCE THE SIZE OF THE GOVERNMENT SECTOR IN TERMS OF VARIOUS EXPENDITURE MEASURES. FOR THE LONGER TERM, IT IS MORE FRUITFUL TO LOOK AT THE SHIFT OF LABOR INTO OTHER SECTORS. CAN THE UK PROVIDE SHORT AND MEDIUM TERM ESTIMATES OF SECTORAL LABOR REQUIREMENTS? THE LONG RUN EFFECT SHOULD BE BENEFICIAL EVEN IF IT CREATES SHORT TERM PROBLEMS.

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8. THE SECRETARIAT (IN PARA 5, REF A)N FORECASTS A STRONG INCREASE IN MANUFACTURING INVESTMENTS THIS YEAR, WHICH IS GENERALLY CONSISTENT WITH BUSINESS SURVEYS. IT IS POSSIBLE THAT THE INCREASE MAY NOT COME ABOUT. THERE

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INR-07 USIA-06 XMB-02 OPIC-03 SP-02 CIEP-01 LAB-04
SIL-01 OMB-01 NSC-05 SS-15 STR-04 CEA-01 NSA-01 /082 W
-----181702 096308 /42

R 181425Z FEB 77

FM AMEMBASSY LONDON

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IS NO EVIDENCE THAT CPAPCITY IS A WIDESPREAD CONSTRAINT,
AND EVEN IF INCREASED EXPORTS DO INDUCE HIGHER LEVELS
OF INVESTMENT, EXPORTS ARE PROGRAMMED TO
INCREASE BY ONLY 6 PERCENT, WHILE CAPITAL'S VALUE
ADDED IN EXPORTS WOULD NOT IMPLY AN ENORMOUS NEED FOR NEW
INVESTMENT. AS MEDIUM TERM PRODUCTIVITY WILL DEPEND UPON
REASONABLE LEVELS OF CAPITAL FORMATION, THE UK

SECRETARIAT SHOULD BE ASKED THEIR VIEWS ON THE DETERMI-
NANTS OF A SUSTAINED INCREASE IN INVESTMENT LEVELS; E.G.,
PROFITS.

9. WHEREAS SECRETARIAT PAPER UNDER POLICY ISSUES SECTION
CORRECTLY RAISES THE LOW LEVEL OF PROFITS AND RELATION OF
THIS TO INVESTMENT IN MANUFACTURING, BELIEVE THESE POINTS
ALSO SHOULD BE INCLUDED IN THE REPORT'S CONCLUSIONS.

10. EMBASSY REPRESENTATIVE AT SESSION WILL BE FINANCIAL
ATTACHE, AMMERMAN.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC REPORTS
Control Number: n/a
Copy: SINGLE
Sent Date: 18-Feb-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977LONDON02885
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D770058-1201
Format: TEL
From: LONDON
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770228/aaaaayhi.tel
Line Count: 200
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 5ca07cc4-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 77 PARIS 4809, 77 LONDON 20292
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 14-Mar-2005 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3283056
Secure: OPEN
Status: NATIVE
Subject: EDRC REVIEW OF THE UNITED KINGDOM
TAGS: EFIN, UK, EDRC
To: STATE TRSY
Type: TE
vdkgvwkey: odb://SAS/SAS.dbo.SAS_Docs/5ca07cc4-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009